Amex's comments.[15] Pending final Commission action on SR–NASD–2001–75, however, Nasdaq believes that the pilot period of the current rule should be extended to allow the rule to remain in effect on an uninterrupted basis.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not:

(i) Significantly affect the protection of investors or the public interest;

(ii) Impose any significant burden on competition; and

(iii) Become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to section 19(b)(3)(A) of the Act[16] and rule 19b–4(f)(6) thereunder.[17] At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

Nasdaq has asked the Commission to waive the five-day pre-filing notice requirement and the 30-day operative delay. The Commission believes waiving the five-day pre-filing notice requirement and the 30-day operative delay is consistent with the protection of investors and the public interest. Such waivers will allow the pilot to operate without interruption through August 15, 2003. For these reasons, the Commission designates the proposal to be effective and operative upon filing with the Commission.[18]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to file number SR–NASD–2003–82 and should be submitted by June 19, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[19]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 03–13448 Filed 5–28–03; 8:45 am]

BILLING CODE 8010–01–P

[15] *See* April 11, 2003 letter from John M. Yetter, Assistant General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission.

[16] 15 U.S.C. 78s(b)(3)(A).

[17] 17 CFR 240.19b–4(f)(6).

[18] For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[19] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47912; File Nos. SR–NYSE–2002–49; SR–NASD–2002–154]

Self-Regulatory Organizations: Notice of Filing of Amendment No. 2 to Proposed Rule Changes by the New York Stock Exchange, Inc. Relating to Exchange Rules 344 (''Supervisory Analysts''), 345A (''Continuing Education for Registered Persons''), 351 (''Reporting Requirements'') and 472 (''Communications With the Public'') and by the National Association of Securities Dealers, Inc. Relating to NASD Rule 2711 (''Research Analysts and Research Reports'')

May 22, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on May 16, 2003, the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') Amendment No. 2 to its proposed rule change (''NYSE Amendment No. 2''), which it originally filed on October 9, 2002 and subsequently amended on December 4, 2002.[3]

On May 20, 2003, the National Association of Securities Dealers, Inc. (''NASD'') filed Amendment No. 2 to its proposed rule change (''NASD Amendment No. 2''), which it originally filed on October 25, 2002 and subsequently amended on December 18, 2002.[4] The proposed rule changes, incorporating NYSE Amendment No. 1 and NASD Amendment No. 1, were published for comment in the **Federal Register** on January 7, 2003.[5]

NYSE Amendment No. 2 and NASD Amendment No. 2 are described in Items I, II, and III below, which Items have been prepared by the respective self-regulatory organizations (''SROs''). The Commission is publishing this notice to solicit comments on NYSE Amendment No. 2 and NASD Amendment No. 2 from interested persons.

I. Self-Regulatory Organizations' Statements of the Terms of Substance of the Proposed Rule Changes

The NYSE is filing with the SEC proposed amendments to NYSE Rule 472 (''Communications with the Public'') to conform to the requirements of the Sarbanes-Oxley Act of 2002 (''SOA''),[6] and providing for an interpretation to the public appearance and print media disclosure requirements of NYSE Rule 472.

NASD is submitting an amendment to SR–NASD–2002–154, a proposed rule change to strengthen rules that govern analyst conflicts of interest by amending NASD Rules 1120 and 2711 and creating a new NASD Rule 1050. NASD Amendment No. 2 would implement provisions of the SOA related to analyst conflicts of interest, create an exemption from some provisions of NASD Rule 2711 for certain smaller firms, and make certain other changes to the current rule.

Below is the text of the proposed rule changes. Proposed new language is in

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Letter from Darla Stuckey, Corporate Secretary, NYSE, to James A. Brigagliano, Assistant Director, Division of Market Regulation (''Division''), Commission (''NYSE Amendment No. 1''). NYSE Amendment No. 1 conformed aspects of the proposed NYSE rules to those of NASD (*See* SR–NASD–2002–154), and proposed effective dates for the various rule provisions.

[4] *See* Letter from Philip Shaikun, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division, Commission (''NASD Amendment No. 1''). NASD Amendment No. 1 clarified that only research analysts who are directly responsible for the preparation of research reports would be required to register with NASD and pass a qualification examination (*See* proposed NASD Rule 1050). NASD Amendment No. 1 also conformed NASD's proposed research analyst compensation provisions to comparable NYSE provisions. NASD Amendment No. 1 also amended the definition of ''research report'' to conform it to the definition in the Sarbanes-Oxley Act of 2002. NASD Amendment No. 1 also revised certain language that was contained in the discussion of the proposed amendment concerning print media interviews and articles.

[5] *See* Securities Exchange Act Release No. 47110 (December 31, 2002), 68 FR 826 (''Original Notice'').

[6] Pub. L. 107–204, 116 Stat. 745 (2002).

italics; proposed deletions are in [brackets].

A. *NYSE's Proposed Rule Text*

Rule 472 Communications With the Public

Approval of Communications and Research Reports

(a)(1) Each advertisement, market letter, sales literature or other similar type of communication which is generally distributed or made available by a member or member organization to customers or the public must be approved in advance by a member, allied member, supervisory analyst, or qualified person designated under the provisions of Rule 342(b)(1).

(2) Research reports must be [prepared or] approved, in advance, by a supervisory analyst acceptable to the Exchange under the provisions of Rule 344. Where a supervisory analyst does not have technical expertise in a particular product area, the basic analysis contained in such report may be co-approved by a product specialist designated by the organization. In the event that the member organization has no principal or employee qualified with the Exchange to approve such material, it must be approved by a qualified supervisory analyst in another member organization by arrangement between the two member organizations.

Investment Banking, Research Department and Subject Company Relationships and Communications

(b)(1) Research Department personnel or any associated person(s) engaged in the preparation of research reports may not be subject to the supervision or control of the Investment Banking Department of the member or member organization.

(2) Research reports may not be subject to review or approval prior to *publication* [distribution] by [the] Investment Banking [Department] *personnel or any other employee of the member or member organization who is not directly responsible for investment research (''non-research personnel'') other than Legal or Compliance Department personnel.*

(3) [(2)] [Investment Banking personnel] *Non-research personnel* may *review* [check] research reports prior to *publication* [distribution] only to verify the factual accuracy of information *in the research report* [and] *or* to identify [or to review for] any potential conflicts of interest that may exist, provided that:

(i) any [such] written communication concerning the *content* [accuracy] of *a* research report[s] between [the Investment Banking] *non-research personnel* and Research [Departments] *personnel* must be made either through [the] Legal or Compliance [Department] *personnel* or in a transmission copied to Legal or Compliance *personnel;* and

(ii) any [such] oral communication concerning the *content* [accuracy] of *a* research report[s] between [the Investment Banking] *non-research personnel* and Research [Departments] *personnel* must be documented and made either with Legal or Compliance personnel acting as intermediary or in a conversation conducted in the presence of Legal or Compliance personnel.

(4) [(3)] A member or member organization may not submit a research report to the subject company prior to *publication,* [distribution,] except for the review of sections of a draft of the research report solely to verify facts. Members and member organizations may not, under any circumstances, provide the subject company sections of research reports that include the research summary, the research rating or the price target.

(i) Prior to submitting any sections of the research report to the subject company, the Research Department must provide a complete draft of the research report to the Legal or Compliance Department.

(ii) If after submission to the subject company, the Research Department intends to change the proposed rating or price target, the Research Department must provide written justification to, and receive prior written authorization from, the Legal or Compliance Department for any change. The Legal or Compliance Department must retain copies of any drafts and changes thereto of the research reports provided to the subject company.

(iii) The member or member organization may not notify a subject company that a rating will be changed until after the close of trading in the principal market of the subject company one business day prior to the announcement of the change.

(5) No member or member organization may publish or otherwise distribute a research report prepared by an associated person nor may an associated person make a public appearance concerning a subject company if the associated person engaged in any communication with the subject company in furtherance of obtaining investment banking business prior to the time the subject company entered into a letter of intent or other written agreement with the member or member organization designating the member or member organization as an underwriter of an initial public offering by the subject company. This provision shall not apply to any due diligence communication between the associated person and the subject company, the sole purpose of which was to analyze the financial condition and business operations of the subject company.

Written Procedures

(c) Each member and member organization must establish written procedures reasonably designed to ensure that members, member organizations, and their associated persons are in compliance with this Rule (see Rule 351(f) and *Rule 472(h)(2)* for attestations to the Exchange regarding compliance).

Retention of Communications

(d) Communications with the public prepared or issued by a member or member organization must be retained in accordance with Rule 440 (''Books and Records''). The names of the persons who prepared and who reviewed and approved the material must be ascertainable from the retained records and the records retained must be readily available to the Exchange, upon request.

Restrictions on Trading Securities by Associated Persons

(e)(1) No associated person or member of the associated person's household may purchase or receive an issuer's securities prior to its initial public offering (*e.g.,* so-called pre-IPO shares), if the issuer is principally engaged in the same types of business as companies (or in the same industry classification) which the associated person usually covers in research reports.

(2) No associated person or member of the associated person's household may trade in any recommended subject company's securities or derivatives of such securities for a period of thirty (30) calendar days prior to and five (5) calendar days after the member's or member organization's *publication* [issuance] of research reports concerning such security or a change in rating or price target of a subject company's securities.

(3) No associated person or member of the associated person's household may effect trades contrary to the member's or member organization's most current recommendations (*i.e.,* sell securities while maintaining a ''buy'' or ''hold'' recommendation, buy securities while maintaining a ''sell'' recommendation, or effecting a ''short sale'' in a security while maintaining a ''buy'' or ''hold'' recommendation on such security).

(4) The following are exceptions to the prohibitions contained in paragraphs (1), (2), and (3):

(i) transactions by associated persons and household members that have been pre-approved in writing by the Legal or Compliance Department that are made due to an unanticipated significant change in their personal financial circumstances;

(ii) a member or member organization may permit the *publication* [issuance] of research reports or permit a change to the rating or price target on a subject company, regardless of whether an associated person and/or household members traded the subject company's securities or derivatives of such securities, within the thirty (30) calendar day period described in paragraph (e)(2), when the *publication* [issuance] of such research reports, or change in such rating or price target is attributable to some significant news or events regarding the subject company, provided that the *publication* [issuance] of such research reports, or change in rating or price target on such subject company has been pre-approved in writing by the Legal or Compliance Department;

(iii) sale transactions by an associated person and/or household member who is new to the member or member organization within thirty (30) calendar days of such associated person's employment with the member or member organization when such associated person and/or household member had previously purchased such security or derivatives of such security prior to the associated person's employment with the member or member organization;

(iv) sale transactions by an associated person and/or household member within thirty (30) calendar days from the date of the member's or member organization's *publication* [issuance] of research reports or changes to the rating or price target on a subject company when such associated person and/or household member had previously purchased the subject company's securities or derivatives of such securities prior to initiation of coverage of the subject company by the associated person;

(v) transactions in accounts not controlled by the associated person and for investment funds in which an associated person or household member participates as a passive investor, provided the interest of the associated person or household member in the assets of the fund does not exceed 1% of the fund's assets, and the fund does not invest more than 20% of its assets in securities of issuers principally engaged in the same types of business as companies (or in the same industry classification) which the associated person usually covers in research reports. If an investment fund distributes securities in kind to an associated person before the issuer's initial public offering, the associated person must either divest those securities immediately or refrain from participating in the preparation of research reports concerning that issuer;

(vi) transactions in a registered diversified investment company as defined under section 5(b)(1) of the Investment Company Act of 1940.

Restrictions on Member's or Member Organization's Issuance of Research Reports *and Participation in Public Appearances*

(f)(1) A member or member organization may not *publish or otherwise distribute* [issue] research reports regarding an issuer *or recommend an issuer's securities in a public appearance,* for which the member or member organization acted as manager or co-manager of an initial public offering within forty (40) calendar days following the *offering date* [effective date of the offering].

(2) A member or member organization may not *publish or otherwise distribute* [issue] research reports regarding an issuer *or recommend an issuer's securities in a public appearance,* for which the member or member organization acted as manager or co-manager of a secondary offering within ten (10) calendar days following the *offering date* [effective date of the offering]. This prohibition shall not apply to research reports [issued] *published or otherwise distributed* under Securities Act Rule 139 regarding issuers whose securities are actively traded, as defined in Securities Exchange Act Rule 101(c)(1) of Regulation M.

(3) No member or member organization that has agreed to participate or is participating as an underwriter or dealer (other than as manager or co-manager) of an issuer's initial public offering may publish or otherwise distribute a research report regarding that issuer for twenty-five (25) calendar days following the offering date.

(4) No member or member organization which has acted as a manager or co-manager of a securities offering may publish or otherwise distribute a research report or make a public appearance within fifteen (15) days prior to or after the expiration, waiver or termination of a lock-up agreement or any other agreement that the member or member organization has entered into with a subject company and its shareholders that restricts or prohibits the sale of the subject company's or its shareholder's securities after the completion of a securities offering.

(5) [(3)] A member or member organization may permit exceptions to the prohibitions in paragraphs (f)(1), [and] (2), *(3) and (4)* (consistent with other securities laws and rules) for research reports that are *published or otherwise distributed* [issued] due to significant news or events, provided that such research reports are pre-approved in writing by the *member's or member's organization's* Legal or Compliance Department.

(6) If a member or member organization withdraws its research coverage of a subject company, notice of this withdrawal must be made. Such notice must be made in the same manner as when research coverage was first initiated by the member or member organization and must include the member's or member organization's final recommendation or rating.

Prohibition *on* [of] Offering Favorable Research for Business *and Retaliation Against Associated Persons*

(g)(*1*) No member or member organization may directly or indirectly offer a favorable research rating or specific price target, or offer to change a rating or price target, to a subject company as consideration or inducement for the receipt of business or for compensation.

(2) No member or member organization and no employee of a member or member organization who is involved with the member's or member organization's investment banking activities may, directly or indirectly, retaliate against or threaten to retaliate against any associated person employed by the member or member organization or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report written or public appearance made by the associated person that may adversely affect the member's or member organization's present or prospective investment banking relationship with the subject company of a research report. This prohibition shall not limit a member's or member organization's authority to discipline or terminate an associated person, in accordance with the member's or member organization's policies and procedures, for any cause other than the writing of such an unfavorable research report or the making of such unfavorable public appearance.

Restrictions on Compensation to Associated Persons

(h)(*1*) No member or member organization may compensate an associated person(s) for specific investment banking services transactions. An associated person may not receive an incentive or bonus that is based on a specific investment banking services transaction. However, a member or member organization is not prohibited from compensating an associated person based upon such *member's or member organization's* [person's] overall performance, including [services provided to] the *performance of the* Investment Banking Department (see Rule 472(k)(2) for disclosure of such compensation).

(2) An associated person's compensation must be reviewed and approved at least annually by a committee which reports to the Board of Directors or, where the member or member organization has no Board of Directors, to a senior executive officer of the member or member organization. Such committee may not include representatives from the member's or member organization's Investment Banking Department. The committee must, among other things, consider the following factors, if applicable, when reviewing an associated person's compensation:

i. The associated person's individual performance, (e.g., productivity, and quality of research product);

ii. The correlation between the associated person's recommendations and stock price performance;

iii. The overall ratings received from clients, sales force, and peers independent of the Investment Banking Department, and other independent rating services.

The committee may not consider as a factor in determining the associated person's compensation, his or her contributions to the member's or member organization's investment banking business.

The committee must document the basis upon which each associated person's compensation was established. The annual attestation required by Rule 351(f) must certify that the committee reviewed and approved each associated person's compensation and has documented the basis upon which such compensation was established.

General Standards for All Communications

(Formerly positioned at Supplementary Material .30)

A. (i) No change.

Specific Standards for Communications

(Formerly positioned at Supplementary Material .40)

B. (j) No change (except for deletion of .40(2)).

Disclosure

(k)(1) Disclosures Required in Research Reports and Public Appearances Disclosure of Member's, Member Organization's, and Associated Person's Ownership of Securities *and Subject Company Relationships*

(i) A member or member organization must disclose in research reports and an associated person must disclose in public appearances:

a. if, as of the last day of the month before the publication or appearance (or the end of the second most recent month if the publication or appearance is less than ten (10) calendar days after the end of the most recent month), the member or member organization or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. The member or member organization must make the required beneficial ownership computation no later than ten (10) calendar days after the end of the prior month. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under section 13(d) of the Securities Exchange Act of 1934,

b. if the associated person or a household member has a financial interest in the securities of the subject company, *and the nature of the financial interest, including, without limitation, whether it consists of any option, right, warrant, futures contract, long or short position,* [or]

c. *if the subject company currently is a client of the member or member organization or was a client of the member or member organization during the 12-month period preceding the date of distribution of the research report or date of the public appearance by the associated person (if the associated person knows or has reason to know). In such instances, the member or member organization or associated person (if such associated person knows or has reason to know) also must disclose the types of services provided to the subject company (For purposes of this paragraph, the types of services provided to the subject company may be described as investment banking services, non-investment banking-securities related services, and non-securities services.),*

d. [c.] any other actual, material conflict of interest of the *associated person,* or member *or* member organization, *of* which the associated person knows, or has reason to know, at the time the research report is *published* [issued] or at the time the public appearance is made.

e. if the associated person or member of the associated person's household is an officer, director, or advisory board member of the subject company; or

f. if the associated person received any compensation from the subject company in the past twelve (12) months.

Associated Person Disclosure

(ii) An associated person must disclose in public appearances (if the associated person knows or has reason to know) if the member or member organization or any affiliate thereof, received any compensation from the subject company in the past twelve (12) months.

Member, *Member* Organization*, and Affiliate* Compensation

(iii) [(ii)] A member or member organization must disclose in research reports if the member or member organization or its affiliates: (a) Has managed or co-managed a public offering of [equity] securities for the subject company in the past twelve (12) months; (b) has received compensation for investment banking services from the subject company in the past twelve (12) months; *(c) received any compensation other than for investment banking services from the subject company in the past twelve (12) months;* or *(d)* [c] expects to receive or intends to seek compensation for investment banking services from the subject company in the next three (3) months.

[When an associated person recommends securities in a public appearance, the associated person must disclose if the subject company is an investment banking services client of the member, member organization, or one of its affiliates; when the associated person knows or has reason to know of this relationship.]

[Disclosure of Associated Person's Affiliations With Subject Company

(iii) A member or member organization must disclose in research reports, and an associated person must disclose in public appearances, whether the associated person or member of the associated person's household is an officer, director or advisory board member of the recommended issuer.]

Exceptions to the Required Disclosures

(iv) A member or member organization or an associated person will not be required to make a

disclosure required by Rule 472(k)(1)(i)c. and (iii) (b) and (d) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking services transactions of the subject company.

(k)(2) Disclosures Specific to Research Reports.

The front page of a research report either must include the disclosures required under this Rule or must refer the reader to the page(s) on which each such disclosure is found. Disclosures, and references to disclosures, must be clear, comprehensive, and prominent.

A member or member organization must disclose in research reports if the associated person preparing such reports received compensation that is based upon (among other factors) the member's or member organization's overall investment banking revenues.

A member or member organization must disclose in research reports that recommend securities:

(i) if it is making a market in the subject company's securities at the time the research report is issued.

(ii) the valuation methods used, and any price objectives must have a reasonable basis and include a discussion of risks.

(iii) the meanings of all ratings used by the member or member organization in its ratings system. (For example, a member or member organization might disclose that a ''strong buy'' rating means that the rated security's price is expected to appreciate at least 10% faster than other securities in its sector over the next *twelve* (12)-month period[)]. Definitions of ratings terms also must be consistent with their plain meaning. Therefore, for example, a ''hold'' rating should not mean or imply that an investor should sell a security.)

(iv) the percentage of all securities that the member or member organization recommends an investor ''buy,'' ''hold,'' or ''sell.'' Within each of the three (*3*) categories, a member or member organization must also disclose the percentage of subject companies that are investment banking services clients of the member or member organization within the previous twelve (12) months[.] ([S]see Rule 472.70 for further information[.]).

(v) a chart that depicts the price of the subject company's stock over time and indicates points at which a member or member organization assigned or changed a rating or price target. This provision would apply only to securities that have been assigned a rating for at least one *(1)* year, and need not extend more than three *(3)* years prior to the date of the research report. The information in the price chart must be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than fifteen (15) calendar days after the most recent calendar quarter).

When a member or member organization distributes a research report covering six (6) or more subject companies for purposes of the disclosures required in paragraph (k) of this Rule, such research report may direct the reader in a clear and prominent manner as to where they may obtain applicable current disclosures in written or electronic format.

Other Communications Activities

(l) Other communications activities are deemed to include, but are not limited to, conducting interviews with the media, writing books, conducting seminars or lecture courses, writing newspaper or magazine articles, or making radio/TV appearances.

Members and member organizations must establish specific written supervisory procedures applicable to members, allied members, and employees who engage in these types of communications activities. These procedures must include provisions that require prior approval of such activity by a person designated under the provisions of Rule 342(b)(1). These types of activities are subject to the general standards set forth in paragraph (i). In addition, any activity which includes discussion of specific securities and/or industries is subject to the specific standards in paragraph (j) and the disclosure requirements of paragraphs (k)(1) and (k)(2)(i).

Small Firm Exception

(m) The provisions of Rule 472(b)(1), (2) and (3) do not apply to members and member organizations that over the three previous years, on average per year, have participated in 10 or fewer investment banking services transactions as manager or co-manager and generated $5 million or less in gross investment banking services revenues from those transactions. For purposes of this paragraph the term ''investment banking services transactions'' shall include both debt and equity underwritings. Members and member organizations that qualify for this exemption must maintain records for three years of any communications that, but for this exemption, would be subject to paragraphs (b)(1), (2), and (3) of this Rule.

.10 Definitions

(1) Communication—The term ''Communication'' is deemed to include, but is not limited to, advertisements, market letters, research reports, sales literature, electronic communications, communications in and with the press, and wires and memoranda to branch offices or correspondent firms which are shown or distributed to customers or the public.

(2) Research Report—''Research report'' is generally defined as a written or electronic communication which includes an analysis of equity securities of individual companies or industries, *and* provides information reasonably sufficient upon which to base an investment decision [and includes a recommendation].

For purposes of approval by a supervisory analyst pursuant to Rule 472(a)(2), research report includes, but is not limited to, reports which recommend equity securities, derivatives of such securities, including options, debt and other types of fixed income securities, single stock futures products, and other investment vehicles subject to market risk.

(3) Advertisement—''Advertisement'' is defined to include, but is not limited to, any sales communications that is published, or designed for use in any print, electronic or other public media such as newspapers, periodicals, magazines, radio, television, telephone recording, Web sites, motion pictures, audio or video device, telecommunications device, billboards, or signs.

(4) Market letters—''Market letters'' are defined as, but are not limited to, any written comments on market conditions, individual securities, or other investment vehicles that are not defined as research reports. They also may include ''follow-ups'' to research reports and articles prepared by members or member organizations which appear in newspapers and periodicals.

(5) Sales literature—''Sales literature'' is defined as, but is not limited to, written or electronic communications including, but not limited to, telemarketing scripts, performance reports or summaries, form letters, seminar texts, and press releases discussing or promoting the products, services, and facilities offered by a member or member organization, the role of investment in an individual's overall financial plan, or other material calling attention to any other communication.

.20 For purposes of this Rule, ''investment banking services'' includes, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture

capital, equity lines of credit, PIPEs (private investment, public equity transaction), or similar investments; or serving as placement agent for the issuer.

.30 For purposes of this Rule, the term ''Investment Banking Department'' means any department or division of the member or member organization, whether or not identified as such, that performs any investment banking services on behalf of the member or member organization.

.40 For purposes of this Rule, the term ''associated person'' includes a member, allied member, or employee of a member or member organization responsible for, and any person who reports directly or indirectly to such associated person in connection with, the *preparation* of [making of the recommendation to purchase, sell or hold an equity security in] research reports, or *making recommendations or offering opinions in* public appearances or establishing a rating or price target of a subject company's equity securities. For purposes of this Rule, the term ''household member'' means any individual whose principal residence is the same as the associated person's principal residence. Paragraphs (e)(1), (2), (3); (4)(i), (ii), (iii), (iv) and (v); (k)(1)(i)b., *and (k)(1)(i)e.* [(k)(1)(iii)] apply to any account in which an associated person has a financial interest, or over which the associated person exercises discretion or control, other than an investment company registered under the Investment Company Act of 1940.

This term ''associated person'' also includes such ''other persons,'' e.g., Director of Research, Supervisory Analyst, or member of a committee, who have direct influence and/or control with respect to (1) preparing research reports, or (2) establishing or changing a rating or price target of a subject company's equity securities. Such other persons are subject to the provisions of paragraph (e)(1)–(4) of this Rule.

.50 For purposes of this Rule, the term ''public appearance'' includes, without limitation, participation in a seminar, forum (including an interactive electronic forum), radio, [or] television *or print* media interview, or other public appearance or public speaking activity, *or the writing of a newspaper article or other type of public written medium* in which an associated person makes a recommendation or offers an opinion concerning [an] *any* equity [security] *securities and/or industries.*

.60 For purposes of this Rule, ''subject company'' is the company whose equity securities are the subject of research reports.

.70 For purposes of Rule 472(k)(2)(iv), a member or member organization must determine, based on its own ratings system, into which of the three (3) categories each of their securities ratings utilized falls. This information must be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than fifteen (15) calendar days after the most recent calendar quarter). For example, a research report might disclose that the member or member organization has assigned a ''buy'' rating to 58% of the securities that it follows, a ''hold'' rating to 15%, and a ''sell'' rating to 27%.

Rule 472(k)(2)(iv) requires members or member organizations to disclose the percentage of companies that are investment banking services clients for each of the three ratings categories within the previous twelve (12) months. For example, if *twenty* (20) of the *twenty-five* (25) companies to which a member or member organization has assigned a ''buy'' rating are investment banking clients of the member or member organization, the member or member organization would have to disclose that 80% of the companies that received a ''buy'' rating are its investment banking clients. Such disclosure must be made for the ''buy,'' ''hold'' and ''sell'' ratings categories as appropriate.

.80 For purposes of this Rule, the term ''Legal or Compliance Department'' also includes, but is not limited to, any department of the member or member organization which performs a similar function.

.90 For purposes of Rule 472(a)*(1),* a qualified person is one who has passed an examination acceptable to the Exchange.

.100 For purposes of this Rule, the term ''initial public offering'' refers to the initial registered equity security offering by an issuer, regardless of whether such issuer is subject to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, prior to the time of the filing of such issuer's registration statement.

.110 For purposes of this Rule, a secondary offering shall include a registered follow-on offering by an issuer or a registered offering by persons other than the issuer involving the distribution of securities subject to Regulation M of the Securities Exchange Act of 1934.

.120 *For purposes of this Rule, the term ''offering date'' refers to the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public.*

Reporting Requirements

Rule 351

(a)–(e) No change.

(f) Each member and member organization that prepares, issues or distributes [communications to the public, (including but not limited to,] research reports *and whose associated persons make public appearances* [, media presentations and interviews)], is required to submit to the Exchange annually, a letter of attestation signed by a senior officer or partner that the member or member organization has established and implemented procedures reasonably designed to comply with the provisions of Rule 472. *The attestation must also specifically certify that each associated person's compensation was reviewed and approved in accordance with the requirements of Rule 472(h)(2) and that the basis for such approval has been documented.*

* * * * *

.11 For purposes of Rule 351(f), the attestation must be submitted by April 1 of each year.

.12 The term ''research report'' is defined in Rule 472.10 and the term ''public appearance'' is defined in Rule 472.50.

Securities Analysts and Supervisory Analysts

Rule 344. *Securities analysts and supervisory analysts must be registered with, qualified by, and approved by the Exchange.*

[Supervisory analysts required under Rule 472 shall be acceptable to, and approved by, the Exchange.]

.10 For purposes of this Rule, the term ''securities analyst'' includes a member, allied member, or employee who is directly responsible for the preparation of research reports. Securities analyst candidates must pass a qualification examination acceptable to the Exchange.

.11 [.10] *For purposes of this Rule, the term ''supervisory analyst'' includes a member, allied member, or employee who is responsible for approving research reports under Rule 472(a)(2).* In order to show evidence of acceptability to the Exchange as a supervisory analyst, a member, allied member, or employee may do one of the following:

(1) Present evidence of appropriate experience and pass an Exchange Supervisory Analyst[s] Examination (*Series 16*).

(2) Present evidence of appropriate experience and successful completion of

a specified level of the Chartered Financial Analysts Examination prescribed by the Exchange and pass only that portion of the Exchange Supervisory Analyst[s] Examination (*Series 16*) dealing with Exchange rules on research standards and related matters.

[In addition, if not a member, allied member or registered representative, the candidate is subject to Exchange investigation of character and conduct and should submit personal information on Form U–4 for this purpose.]

The Exchange publishes a Study Outline for the *Securities Analyst Examination and the* Supervisory Analyst[s] Examination (*Series 16*). [Examinations are requested and given under the procedures described in Para. of 2345.15 for registered representative examinations.]

Continuing Education for Registered Persons

Rule 345A. (a) Regulatory Element—No change.

(b) Firm Element.

(1) Persons Subject to the Firm Element—The requirements of section (b) of this Rule shall apply to any registered person who has direct contact with customers in the conduct of the member's or member organization's securities sales, trading or investment banking activities, and to the immediate supervisors of such persons, *and to registered persons who function as* supervisory analysts, *and securities analysts as defined in Rule 344* (collectively, ''covered registered persons'').

(2) Standards—No Change.

(3) Participation in the Firm Element—No Change.

(4) Specific Training Requirements—The Exchange may require a member or member organization, either individually or as part of a larger group, to provide specific training to its covered registered persons in such areas the Exchange deems appropriate. Such a requirement may stipulate the class of covered registered persons for which it is applicable, the time period in which the requirement must be satisfied and, where appropriate, the actual training content.

.10 For purposes of this Rule, the term ''registered person'' means any member, allied member, registered representative, or other person registered or required to be registered under Exchange rules, but does not include any such person whose activities are limited solely to the transaction of business on the Floor with members or registered broker-dealers. *For purposes of the Regulatory Element required under Rule 345A(a), the term does not include persons registered as securities analysts, or supervisory analysts pursuant to Rule 344.*

.20–.40 No Change.

.50 Pursuant to Rule 345A(b)(1), all persons registered as securities analysts and supervisory analysts pursuant to Rule 344 must participate in a Firm Element Continuing Education program that includes training in applicable rules and regulations, ethics, and professional responsibility.

Interpretation

Rule 472 Communications With the Public

(k)(1) Disclosure Required in Research Reports and Public Appearances.

/01 Public Appearances—Print Media.

When an associated person recommends securities in a print or broadcast media interview, newspaper article or other type of public medium all of the disclosures required under Rule 472(k)(1) are required to be provided to the media outlet for inclusion in the published interview, article, broadcast, or other medium.

Whenever an associated person recommends securities in a print media interview, newspaper article prepared under his or her name, or broadcast, the associated person, before the opening of business on the next business day, must prepare a record of such interview, article or broadcast. Such record must include, at minimum, the name of the analyst(s), the name of the publication, the date of the interview, article, or broadcast the name of the interviewer (if applicable), the name(s) of the securities recommended and the specific disclosures provided to the print or broadcast media source and/or interviewer. Such record must be made regardless of whether the media outlet published or broadcast the required disclosures. The associated person's member or member organization must retain the record of such interview, article, or broadcast and the disclosures made in accordance with Rules 17a–and 17a–4 of the Securities Exchange Act of 1934. The record retained must be readily available to the Exchange, upon request.

B. *NASD's Proposed Rule Text*

1050. Registration of Research Analysts

All persons associated with a member who are to function as research analysts as that term is defined in Rule 2711 shall be registered with NASD. Before their registrations can become effective, they shall pass a Qualification Examination for Research Analysts as specified by the Board of Governors. For purposes of this Rule 1050, ''research analyst'' shall mean an associated person who is directly responsible for the preparation of research reports.

* * * * *

1120. Continuing Education Requirements

This Rule prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with the Association. The requirements shall consist of a Regulatory Element and a Firm Element as set forth below.

(a) Regulatory Element

(1) through (4) No change.

(5) Definition of Registered Person.

For purposes of this Rule, the term ''registered person'' means any person registered with [the Association] *NASD* as a representative, principal, [or] assistant representative *or research analyst* pursuant to Rule 1020, 1030, 1040, *1050* and 1110 Series.

(6) No change.

(b) Firm Element

(1) Persons Subject to the Firm Element.

The requirements of this subparagraph shall apply to any person registered with the member who has direct contact with customers in the conduct of the member's securities sales, trading and investment banking activities, and to the immediate supervisors of such persons, *and to any person registered as a research analyst pursuant to Rule 1050* (collectively, ''covered registered persons''). ''Customer'' shall mean any natural person and any organization, other than another broker or dealer, executing securities transactions with or through or receiving investment banking services from a member.

(2) Standards for the Firm Element.

(A) No change.

(B) Minimum Standards for Training Programs—Programs used to implement a member's training plan must be appropriate for the business of the member and, at a minimum must cover the following matters concerning securities products, services, and strategies offered by the member:

(i) General investment features and associated risk factors;

(ii) Suitability and sales practice considerations; [and]

(iii) Applicable regulatory requirements[.]*; and*

(iv) With respect to registered research analysts, training in ethics, professional responsibility and the requirements of Rule 2711.

(3) through (4) No change.

* * * * *

2711. Research Analysts and Research Reports

(a) Definitions

For purposes of this rule, the following terms shall be defined as provided.

(1) through (3) No change.

(4) ''Public appearance'' means any participation in a seminar, forum (including an interactive electronic forum), radio, television *or print media* interview, or other public speaking activity, *or the writing of a print media article,* in which a research analyst makes a recommendation or offers an opinion concerning an equity security.

(5) ''Research analyst'' means the associated person who is principally responsible for, and any associated person who reports directly or indirectly to such a research analyst in connection with, preparation of the substance of a research report, whether or not any such person has the job title of ''research analyst.'' *Solely for purposes of paragraph (g), the term ''research analyst'' also includes such other persons as the director or research, supervisory analyst, or member of a committee who have direct influence or control with respect to (A) the preparation of research reports, or (B) establishing or changing a rating or price target of a subject company's equity securities.*

(6) through (7) No change.

(8) ''Research report'' means a written or electronic communication which includes an analysis of equity securities of individual companies or industries, and which provides information reasonably sufficient upon which to base an investment decision [and includes a recommendation].

(9) No change.

(b) Restrictions on [Investment Banking Department] Relationships with Research Department

(1) No research analyst may be subject to the supervision or control of any employee of the member's investment banking department.

(2) Except as provided in paragraph (b)(3), no employee of the investment banking department *or any other employee of the member who is not directly responsible for investment research (''non-research personnel''), other than legal or compliance personnel,* may review or approve a research report of the member before its publication.

(3) [Investment banking] *Non-research* personnel may review a research report before its publication as necessary only to verify the factual accuracy of information in the research report or [to review the research report for] *identify* any potential conflict of interest, provided that:

(A) any written communication between [investment banking] *non-research personnel* and research department personnel concerning [such] *the content* of a research report must be made either through [an] authorized legal or compliance [official] *personnel* of the member or in a transmission copied to such [an official] *personnel;* and

(B) any oral communication between [investment banking] *non-research personnel* and research department personnel concerning [such] *the content of* a research report must be documented and made either through [an] authorized legal or compliance [official] *personnel* acting as intermediary or in a conversation conducted in the presence of such [an official] *personnel.*

(c) Restrictions on Review of a Research Report by the Subject Company

(1) No change.

(2) A member may submit sections of such a research report to the subject company before its publication for review as necessary only to verify the factual accuracy of information in those sections, provided that:

(A) No change.

(B) a complete draft of the research report is provided to [the] legal or compliance [department] *personnel* before sections of the report are submitted to the subject company; and

(C) if after submitting the sections of the research report to the subject company the research department intends to change the proposed rating or price target, it must first provide written justification to, and receive written authorization from, [the] legal or compliance [department] *personnel* for the change. The member must retain copies of any draft and the final version of such a research report for three years following its publication.

(3) No change.

(4) No research analyst may issue a research report or make a public appearance concerning a subject company if the research analyst engaged in any communication with the subject company in furtherance of obtaining investment banking business prior to the time the subject company entered into a letter of intent or other written agreement with the member designating the member as an underwriter of an initial public offering by the subject company. This provision shall not apply to any due diligence communication between the research analyst and the subject company, the sole purpose of which was to analyze the financial condition and business operations of the subject company.

(d) [Prohibition of Certain Forms of] *Restrictions on* Research Analyst Compensation

(1) No member may pay any bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking services transaction.

(2) A research analyst's compensation must be reviewed and approved at least annually by a committee that reports to the member's board of directors, or when the member has no board of directors, to a senior executive officer of the member. This committee may not have representation from the member's investment banking department. The committee must consider the following factors when reviewing a research analyst's compensation, if applicable:

(A) the research analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;

(B) the correlation between the research analyst's recommendations and the stock price performance; and

(C) the overall ratings received from clients, sales force, and peers independent of the member's investment banking department, and other independent ratings services.

The committee may not consider as a factor in determining the research analyst's compensation his or her contributions to the member's investment banking business. The committee must document the basis upon which each research analyst's compensation was established. The annual attestation required by Rule 2711(i) must certify that the committee reviewed and approved each research analyst's compensation and documented the basis upon which this compensation was established.

(e) No change.

(f) [Imposition of Quiet Periods] *Restrictions on Publishing Research Reports and Public Appearances; Termination of Coverage*

(1) No member may publish *or otherwise distribute* a research report regarding a subject company *or recommend a subject company's securities in a public appearance* for

which the member acted as manager or co-manager of:

[(1)]*(A)* an initial public offering, for 40 calendar days following the date of the offering; or

[(2)]*(B)* a secondary offering, for 10 calendar days following the date of the offering; provided that:

[(A)]*(i)* paragraphs (f)(1)*(A)* and (f)[(2)]*(1)(B)* will not prevent a member from publishing *or otherwise distributing* a research report concerning the effects of significant news or a significant event on the subject company within such 40- and 10-day periods, and provided further that [the] legal [and] *or* compliance [department] *personnel* authorize[s] publication of that research report before it is [issued] *published or otherwise distributed;* and

[(B)]*(ii)* paragraph (f)[(2)]*(1)(B)* will not prevent a member from publishing *or otherwise distributing* a research report pursuant to SEC Rule 139 regarding a subject company with ''actively-traded securities,'' as defined in Regulation M, 17 CFR 242.101(c)(1).

(2) No member that has agreed to participate or is participating as an underwriter or dealer (other than as manager or co-manager) of an issuer's initial public offering may publish or otherwise distribute a research report regarding that issuer for 25 calendar days following the date of the offering.

(3) For purposes of paragraphs (f)(1) and (f)(2), the term ''date of the offering'' refers to the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public.

(4) No member that has acted as a manager or co-manager of a securities offering may publish or otherwise distribute a research report or make a public appearance concerning a subject company 15 days prior to and after the expiration, waiver or termination of a lock-up agreement or any other agreement that the member has entered into with a subject company or its shareholders that restricts or prohibits the sale of securities held by the subject company or its shareholders after the completion of a securities offering. This paragraph will not prevent a member from publishing or otherwise distributing a research report concerning the effects of significant news or a significant event on the subject company within such period, provided that legal or compliance personnel authorize publication of that research report before it is issued.

(5) If a member intends to discontinue its research coverage of a subject company, notice of this withdrawal must be made in the same manner as when research coverage was first initiated by the member and must include the member's final recommendation or rating.

(g) Restrictions on Personal Trading by Research Analysts

(1) No change.

(2) (A) No change.

(B) a member may permit a research analyst account to purchase or sell any security issued by a subject company within 30 calendar days before the publication of a research report or change in the rating or price target of the subject company's securities due to significant news or a significant event concerning the subject company, provided that [the member's] legal or compliance [department] *personnel* pre-approve[s] the research report and any change in the rating or price target.

(3) No change.

(4) [A member's l]*Legal* or compliance [department] *personnel* may authorize a transaction otherwise prohibited by paragraphs (g)(2) and (g)(3) based upon an unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account, provided that:

(A) [the] legal or compliance [department] *personnel* authorize[s] the transaction before it is entered;

(B) through (C) No change.

(5) No change.

(h) Disclosure Requirements

(1) No change.

(2) Receipt of Compensation.

(A) A member must disclose in research reports if [:(i)] the research analyst principally responsible for preparation of the report received compensation that is based upon (among other factors) the member's investment banking revenues.[; and]

(B)[(ii) the member or its affiliates:] *A member must disclose in research reports if the member or any affiliate:*

(i)[(a)]managed or co-managed a public offering of securities for the subject company in the past 12 months;

(ii)[(b)] received compensation for investment banking services from the subject company in the past 12 months; or

(iii)[(c)] expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months.

(C) A member must disclose in research reports if the member or any affiliate received any compensation other than for investment banking services from the subject company in the past 12 months.

(D) A member must disclose in research reports and a research analyst must disclose in public appearances if the research analyst received any compensation from the subject company in the past 12 months.

(E) A research analyst must disclose in public appearances (if the analyst knows or has reason to know) if the member or any affiliate received any compensation from the subject company in the past 12 months.

(F) A member must disclose in research reports and a research analyst must disclose in public appearances (if the analyst knows or has reason to know) if the subject company currently is a client of the member or was a client of the member during the 12-month period preceding the date of distribution of the research report or date of the public appearance. In such cases, the member or research analyst (if the analyst knows or has reason to know) also must disclose the types of services provided to the subject company. For purposes of this paragraph (h)(2)(F), the types of services provided to the subject company may be described as investment banking services, non-investment banking securities-related services, and non-securities services.

(G) A member or research analyst will not be required to make a disclosure required by paragraphs (h)(2)(B)(ii), (h)(2)(B)(iii), or (h)(2)(F) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking services transactions of the subject company.

[(B) A research analyst must disclose in public appearances if the analyst knows or has reason to know that the subject company is a client of the member or its affiliates.]

(3) through (11) No change.

(i) No change.

(j) Prohibition of Retaliation Against Research Analysts

No member and no employee of a member who is involved with the member's investment banking activities may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the member or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may adversely affect the member's present or prospective investment banking relationship with the subject company of a research report. This prohibition shall not limit a member's authority to discipline or terminate a research analyst, in accordance with the member's policies and procedures, for any cause other than the writing of such

an unfavorable research report or the making of such an unfavorable public appearance.

(k) Exemption for Small Firms

The provisions of paragraph (b) shall not apply to members that over the previous three years, on average per year, have participated in 10 or fewer investment banking services transactions as manager or co-manager and generated $5 million or less in gross investment banking services revenues from those transactions. For purposes of this paragraph (k), the term ''investment banking services transactions'' includes the underwriting of both debt and equity securities. Members that qualify for this exemption must maintain records for three years of any communication that, but for this exemption, would be subject to paragraph (b) of this Rule.

II. Self-Regulatory Organizations' Statements of the Purpose of, and Statutory Basis for, the Proposed Rule Changes

In their filings with the Commission, the NYSE and NASD included statements concerning the purpose of, and statutory basis for, the proposed rule changes. The text of these statements may be examined at the places specified in Item IV below. The NYSE and NASD have prepared summaries, set forth in sections A, B, and C below of the most significant aspects of such statements.

A. Self-Regulatory Organizations' Statements of the Purpose of, and Statutory Basis for, the Proposed Rule Changes

1. NYSE's Purpose

The Exchange recently adopted sweeping and dramatic rule changes governing the manner in which members and member organizations, their investment banking departments and associated persons (hereinafter referred to as research analysts) manage and disclose conflicts of interest between their investment-banking and research departments. According to NYSE, these amendments were precipitated by a series of events that had eroded investor confidence in the equities markets and called into question the ways in which these conflicts of interest were managed and disclosed to the investing public. According to the NYSE, the additional amendments, pending approval of the SEC and new proposed changes discussed below, were developed by the Exchange in collaboration with the NASD under the guidance of the SEC.

The Exchange believes that the amendments to the NYSE rules proposed in this filing are necessary in order to comply with the mandates of the SOA, which amends the Exchange Act [7] by adding new section 15D [8] which requires the SEC, ''or upon authorization and direction of the Commission, a self-regulatory organization,'' to adopt not later than one year after July 30, 2002, the date of enactment of the SOA, ''rules reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information.'' [9]

The Exchange believes that certain of the disclosure requirements and prohibitions that the SOA mandates have already been adopted in new NYSE Rules. The Exchange believes that the SOA appears to impose different, and in some instances more stringent, requirements than current NYSE Rule 472. According to NYSE, given the complexity and possible ramifications of the changes necessitated by the SOA, the SROs in conjunction with the SEC, spent considerable time examining which aspects of the SRO rules would require further amendments. Accordingly, proposed conforming SOA changes are being made in two phases. In the Original Notice, the Exchange proposed an amendment, discussed below, to the definition of the term ''research report'' contained in NYSE Rule 472.10(2), to conform to the requirements of section 15D(c)(2) of the Exchange Act.[10] The Exchange also proposed an amendment, discussed below, that it believes would satisfy the requirements of section 15D(a)(1)(B) of the Exchange Act by limiting the ''compensatory evaluation of securities analysts to officials employed by the broker or dealer who are not engaged in investment banking activities.'' [11] These proposed amendments are pending with the Commission. According to NYSE, as discussed in more detail below, the Exchange is currently proposing further amendments to its rules in order to conform to the requirements of the SOA.

February 2002 Filing

In February 2002, the Exchange filed with the Commission proposed amendments to Exchange Rules 472 and 351, which were approved by the Commission in May 2002.[12] In the May 10th Order, the SEC also simultaneously approved comparable changes to NASD rules (new NASD Rule 2711—''Research Analysts and Research Reports'').

The rule amendments generally: restrict the relationship between research and investment banking departments and the companies that are the subjects of research reports; require disclosure of a financial interest in a subject company by an analyst or a member or member organization; require disclosure of existing and potential investment banking relationships with a subject company; impose quiet periods for the issuance of research reports following the completion of a company's securities offering; restrict personal trading by research analysts in the securities of the companies covered by such analysts; and generally require extensive disclosure in research reports of certain important information to help customers monitor the correlation between a research analyst's ratings and the price movements of subject companies' securities.

The rule amendments have been phased in incrementally to provide members and member organizations time to develop and implement policies, procedures and systems and hire additional personnel to comply with the new requirements. The staggered implementation of the SRO rules began July 9, 2002, with September 9, 2002 and November 6, 2002 as the effective dates for certain specified provisions.

According to NYSE, as a result of comments received, the SEC approved, on a temporary basis, NYSE rule proposals providing for an exemption from the gatekeeper provisions (NYSE Rules 472(b)(1), (2), and (3)) for members and member organizations that over the three previous years, on average per year, have participated in ten or fewer investment banking services transactions as manager or co-manager and generated $5 million or less in gross investment banking revenues from those transactions (hereinafter referred to as ''small firms'').[13] As discussed in more detail below, the NYSE is proposing that certain elements of the temporary small firm exemption to the gatekeeper provisions be made permanent. During

[7] 15 U.S.C. 78a *et seq.*

[8] 15 U.S.C. 78o–6.

[9] *Id.* at (a).

[10] 15 U.S.C. 78o–6 (c)(2).

[11] 15 U.S.C 78o–6(a)(1)(B).

[12] *See* Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34969 (May 16, 2002) (''May 10th Order'').

[13] *See* Securities Exchange Act Release No. 46182 (July 11, 2002), 67 FR 47013 (July 17, 2002); Securities Exchange Act Release No. 46949 (December 4, 2002), 67 FR 76202 (December 11, 2002).

the interim period, the Exchange, in a separate filing, extended the implementation date for the gatekeeper provisions for small firms until July 30, 2003, or until such date as a permanent exemption is approved by the SEC and becomes effective.[14]

According to NYSE, as a result of numerous interpretive requests, on June 26, 2002, the Exchange and the NASD issued interpretive guidance to certain rule provisions.[15] According to NYSE, upon adoption of the new amendments to the SRO rules, the SROs intend to provide written clarification as to how these rules will impact existing guidance in this area as well as additional issues that may arise once the amendments are adopted.

According to the NYSE, the Exchange, together with other regulatory organizations, also conducted examinations of members' and member organizations' research practices to determine compliance with the new SRO Rules. The Exchange believes that some of the interpretive issues raised by the industry and the preliminary findings from the examinations necessitated certain additional changes, discussed below, to existing NYSE Rules.

October 2002 Filing

In October 2002, the Exchange filed with the SEC proposed amendments to Exchange Rules 472, 351, 344 and 345A.[16] Comparable amendments were also filed by the NASD. The amendments pending with the SEC generally provide for further restrictions on research analysts' compensation, trading activities, issuance of research reports, and notification of research coverage termination, and impose additional disclosure requirements for research reports and research analysts. In addition, pending amendments place certain restrictions on research analysts participating in solicitation or ''pitch'' meetings with prospective investment banking clients.

Amendments pending with the SEC expand the definition of ''research analyst'' (associated person) to include research directors, supervisory analysts and others, (*e.g.*, committee members who have direct influence, or control over the preparation of research reports and establishment or change in ratings or price targets) and thereby subject them to the same trading and ownership prohibitions that the Rule imposes on research analysts.

Following approval, the current 10 and 40-day quiet periods for the issuance of research reports by managers and co-managers of initial and secondary offerings will be extended to include public appearances.

Upon approval by the SEC, the definition of ''public appearance'' will be amended to include research analysts' making a recommendation in a newspaper article or similar public medium. Extending the definition of ''public appearance'' to recommendations in a newspaper article will require research analysts to make the same disclosures that they are required to make in other public appearances. As discussed in more detail below, the Exchange received comments on this proposed amendment.

Proposed amendments to NYSE Rule 344 (''Supervisory Analysts'') pending with the SEC would establish a new registration category and require a qualification examination for research analysts (NYSE Rule 344). In addition, NYSE Rule 345A (''Continuing Education for Registered Persons'') would be amended to include research analysts and supervisory analysts as covered persons subject to the Firm Element of the Continuing Education Program to address applicable rules and regulations, ethics, and professional responsibility.

According to NYSE, pending proposed amendments to the definition of ''research report'' began the process of conforming NYSE Rules to the mandates of the SOA. As proposed, the term ''research report'' as it is currently defined in the NYSE Rule 472.10(2) is being amended to conform to the SOA's definition by deleting the criterion of providing a recommendation from the criteria that determines what constitutes a research report.

According to NYSE, the Exchange filed NYSE Amendment No. 1 for the purpose of conforming proposed NYSE rules to those of the NASD and to establish effective dates, noted below, for the various rule provisions.

Sarbanes-Oxley Act Compliance

According to NYSE, as a result of discussions with the NASD and SEC, the Exchange is filing Amendment No. 2 to propose the following additional changes to NYSE Rule 472 to conform it to the requirements of the SOA.

Section 15D(a)(1)(A) of the Exchange Act requires that rules be designed to restrict ''the prepublication review or approval of research reports by persons employed by the broker-dealer who are engaged in investment banking activities, or persons not directly responsible for investment research, other than legal or compliance staff.'' [17] In the May 10th Order, the Commission approved NYSE Rule 472(b)(1), which prohibits investment banking department review and approval of research reports prior to distribution. According to NYSE, the purpose of that amendment was to help promote fair, objective and unbiased research through the elimination of potential conflicts of interest that are present when an investment banker is able to review, and possibly influence, a research report prior to its publication.

In accordance with the requirements of section 15D(a)(1)(A) of the Exchange Act,[18] the Exchange is proposing amendments that would extend the existing prepublication review and approval prohibition beyond investment banking personnel to anyone associated with the broker or dealer, other than research department personnel (*See* proposed NYSE Rule 472(b)(2) and (3)). In doing so, the Exchange is augmenting its existing rule prohibitions, which it believes is thus helping to foster a better climate for research analysts to produce unbiased research free of the conflicts that had beset the industry prior to the adoption of the SRO Rules last year.

Section 15D(a)(1)(C) of the Exchange Act requires ''that a broker or dealer and persons employed by such broker or dealer who are involved in investment banking activities may not, directly or indirectly retaliate against or threaten to retaliate against any securities analyst employed by that broker or dealer or its affiliates as a result of an adverse, negative or otherwise unfavorable research report that may adversely affect the present or prospective investment banking relationship of the broker or dealer with the issuer that is the subject of the research report.'' [19]

NYSE believes that, although recently enacted NYSE Rule 472 amendments have, to some extent, already addressed this issue, proposed amendments will incorporate the substance of this requirement and extend it to ''public appearances'' as well (*See* proposed NYSE Rule 472(g)(2)). In this regard, the Exchange believes that NYSE Rule 472(b)(1) already prohibits research analysts from being under the supervision and control of an investment banking department, and thus limits, to some degree, the ability

[14] *See* Securities Exchange Act Release No. 47876 (May 15, 2003).

[15] *See* NYSE Information Memo No. 02–26, dated June 26, 2002, and NASD Notice to Members 02–39, dated July 2002.

[16] *See* Securities Exchange Act Release No. 47110 (December 31, 2002), 68 FR 826 (January 7, 2003) (SR–NYSE–2002–49; SR–NASD–2002–154) (''October 2002 Filing'').

[17] 15 U.S.C. 78o–6(a)(1)(A).

[18] *Id.*

[19] 15 U.S.C. 78o–6(a)(1)(C).

of such personnel directly to retaliate against research analysts. According to NYSE, it is generally established that ''control'' refers to the ability to ''hire, fire, reward and punish'' and, thus, prohibiting control of research analysts by an investment banking department limits such opportunities for retaliation.

Further, amendments filed pursuant to the October 2002 Filing that are pending with the SEC would provide for the review and approval of research analysts' compensation by a committee of the member or member organization that reports to its Board of Directors, or where the member or member organization has no Board of Directors, to a senior executive officer of the member or member organization. Such committee would be prohibited from having representatives from the member's or member organization's investment banking department serving on such a committee, and would thus foreclose opportunities for the investment banking department to retaliate against a research analyst by adversely impacting his or her compensation. According to NYSE, in conforming to the SOA's anti-retaliation requirement, the Exchange will expand upon the limitations already imposed and pending limitations on such conduct in NYSE Rule 472.

Section 15D(a)(2) of the Exchange Act imposes quiet periods (*e.g.*, prohibition against publishing or otherwise distributing research reports) on brokers or dealers who have participated, or are to participate in a public offering as underwriters or dealers.[20] Current SRO rules impose quiet periods on the issuance of research reports of 40-days for initial public offerings (''IPOs'') and 10 days for certain secondary offerings.[21] However, these prohibitions apply only to managers and co-managers of securities offerings. NYSE believes that the current SRO quiet periods exceed those provided for under the Federal securities laws.

According to NYSE, in enacting quiet periods that exceeded those currently prescribed under the Federal securities laws,[22] the Exchange was seeking to minimize incentives that managing underwriters, by virtue of their relationships with issuers, would have to reward such issuers for their underwriting business by publishing favorable research soon after the completion of a securities offering. As such, the Exchange believes that extended quiet periods would allow market forces to determine the price of the security in the after-market, regardless of research reports with favorable and potentially biased recommendations.

The proposed amendments impose a 25-day quiet period on underwriters and dealers who are not managers or co-managers of an issuer's IPO (*See* proposed NYSE Rule 472(f)(3)). In doing so, the Exchange will place limitations on the issuance of research reports on any and all distribution participants following an issuer's IPO. The Exchange believes that this will eliminate any possible or potential competitive disadvantage that managers and co-managers are subject to under the current NYSE rule provisions.

In proposing a shorter quiet period for such dealers and underwriters than what is provided for under NYSE Rule 472(f)(1), the Exchange recognizes that such distribution participants, do not, by virtue of their relationships and compensation arrangements with issuers, have the same incentives and opportunities to publish favorable research for such issuers as do managers and co-managers of such offerings. Accordingly, the NYSE believes that a 25-day quiet period is appropriate for such distribution participants. According to NYSE, the Exchange, along with the NASD, is proposing a uniform definition of the term ''offering date'' that will be applied to this new quiet period as well as to the existing ones (NYSE Rule 472(f)(1) and (2)) (*See* proposed NYSE Rule 472.120).

Further, section 15D(a)(2) of the Exchange Act utilizes the term ''publish or otherwise distribute'' in its rule text.[23] Accordingly, the Exchange is proposing to make conforming changes where applicable to its current rule provisions (*See* proposed NYSE Rules 472(b)(2) and (3), NYSE Rules 472(e)(2), (4)(ii) and (iv), (f)(1), (2) and (3)). In addition, the Exchange will be renumbering paragraphs 472(f)(3) through (5) as a result of the above changes.

Section 15D(b)(2) of the Exchange Act requires disclosure of ''whether *any compensation* has been received by a broker or dealer, or any affiliate thereof, including the securities analyst, from the issuer, that is the subject of the appearance or research report, subject to such exemptions as the Commission may determine appropriate and necessary to prevent disclosure of material non-public information regarding specific potential future investment banking transactions of such issuer.'' [24]

Currently, Exchange Rule 472(k)(1)(ii)(b) requires that a member or member organization must disclose in research reports if the member or member organization or its affiliate has received compensation for investment banking services from a subject company in the past twelve (12) months. In addition to this required disclosure, proposed amendments would require disclosure in research reports of receipt of *any compensation,* other than for investment banking services, by a member or member organization from a subject company in the prior twelve (12) months (with no forward-looking provision) (*See* proposed NYSE Rule 472(k)(1)(iii)(c)).

According to NYSE, in requiring this additional disclosure, the Exchange recognizes that the receipt of any compensation, not just that resulting from investment banking services, may lend itself to the types of potential conflicts of interest between members and member organizations and their subject companies, that the initial rule amendments approved in the May 10th Order were promulgated to address, and thus in the interest of investor protection should be disclosed in research reports.

In addition, proposed NYSE Rule 472(k)(1)(ii) would require a research analyst (associated person) to disclose in public appearances (if such person knows or has reason to know) whether the member or member organization or any affiliate thereof, received any compensation from a subject company in the past twelve (12) months. Further, proposed NYSE Rule 472(k)(1)(i)(f) will require disclosure in a research report and public appearances of whether a research analyst (associated person) received any compensation from a subject company in the past twelve (12) months.

Although current NYSE Rules prohibit a research analyst from being compensated for specific investment banking services transactions (*See* NYSE Rule 472(h)(1)), and require disclosure in research reports of whether a research analyst received compensation, based in

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[20] 15 U.S.C. 78o–6(a)(2).

[21] *See* NYSE Rule 472(f)(1), (2); NASD Rule 2711(f).

[22] Currently, Rule 174(d) under the Securities Act of 1933 (the ''Securities Act'') provides for a twenty-five (25)-day prospectus delivery requirement for an issuer's IPO if the security is to be listed on an exchange or authorized for inclusion in an interdealer quotation system such as Nasdaq. 17 CFR 230.174(d). The twenty-five (25)-day quiet period coincides with the twenty-five (25)-day prospectus delivery requirement under this rule. *See* Proposed NYSE Rule 472(f)(3). In addition, the restrictions regarding publication of research reports in Rule 101 of Regulation M do not apply to research reports that comply with Rules 138 or 139 (available to certain S–2 and/or S–3 issuers) under the Securities Act. 17 CFR 242.101(b)(1); 17 CFR 230.138; 17 CFR 230.139.

[23] 15 U.S.C. 78o–6(a)(2).

[24] 15 U.S.C. 78o–6(b)(2).

part on a member's or member organization's investment banking revenue (*See* NYSE Rule 472(k)(2)), the breadth of the new proposed rule requirement is greater in that it would require disclosure of the receipt of any compensation received by a research analyst from the subject company. According to NYSE, the potential for conflicts of interest between a member, member organization, or its research analyst, and a subject company can exist irrespective of the type of compensation received from the subject company. The NYSE believes that the proposed rule requirement will better address this potential conflict by requiring disclosure of any compensation that might possibly compromise a firm, its analyst, and the issuance of a research report on such subject company.

Further, the NYSE believes that the proposed new disclosure requirements are also in keeping with the spirit of the Commission's recently enacted Regulation Analyst Certification (''Regulation AC''),[25] which requires, if applicable, that a research analyst in a research report attest that ''part or all of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the research analyst in the research report,'' and ''further disclosing that the compensation could influence the recommendations or views expressed by the research report.'' [26] As proposed, the Exchange believes that the new disclosure requirements would better enable public investors to determine whether such recommendations made in research reports and during public appearances could have been influenced by the receipt of compensation by the research analyst and his or her member or member organization.

Section 15D(b)(3) of the Exchange Act requires disclosure of ''whether an issuer, whose securities are recommended in a public appearance or research report, currently is, or was, during the 1-year period preceding the appearance or date of distribution of the research report, a client of the broker or dealer, and if so, * * * [a statement of] the type of services provided to the issuer.'' [27] Currently, NYSE Rule 472(k)(1)(ii) requires a research analyst (associated person) to disclose during a public appearance (when such person knows or has reason to know) if a subject company is an investment banking services client of the member or member organization.

According to NYSE, the proposed amendments will provide for disclosure by a member or member organization in research reports and a research analyst (associated person) during a public appearance, of whether a subject company is a client of the member or member organization, and the types of services provided to the client (*See* proposed NYSE Rule 472(k)(1)(i)(c)).

The types of services have been categorized into: investment banking services (which are currently required to be disclosed under NYSE Rule 472(k)(1)(ii)(a)); non-investment banking-securities related services; and non-securities services (*See* proposed NYSE Rule 472(k)(1)(i)(c.).

The Exchange believes that requiring disclosure of whether a subject company is a client and the types of services provided, and not merely an investment banking client of a member or member organization, should provide investors with potentially more meaningful insight into the nature of the relationship between the subject company and the member or member organization and the potential conflicts attendant to such relationships. For example, the Exchange believes that it might be more beneficial for an investor, in determining whether a firm has real conflicts of interest inherent in conducting investment banking on behalf of a subject company, to know that a member or member organization is actually providing non-investment banking securities related services to a subject company, such as conducting a share-buy-back for such company, rather than a securities underwriting.

In requiring that firms and their research analysts enumerate the types of services provided to subject companies, the Exchange recognizes that there is a possibility that this could result in the tipping of material non-public information. This issue was raised with the prior rule amendments, which require disclosure of prospective investment banking compensation (*See* NYSE Rule 472(k)(1)(ii)(c)). According to NYSE, in this regard, the SROs had defined investment banking services broadly enough to mitigate the issue of tipping material non-public information. The Exchange believes that it has also addressed this issue with the proposed new disclosure requirements. As proposed, the rule provides for an exemption from the disclosure requirements of proposed NYSE Rule 472(k)(1)(i)(c) and NYSE Rule 472(k)(1)(iii)(b) and (d) [28] to the extent that such disclosure would reveal material non-public information regarding specific potential future investment banking services transactions of the subject company (*See* proposed NYSE Rule 472(k)(1)(iv)).

The Exchange is proposing to amend NYSE Rule 472(k)(1)(iii)(a),[29] which requires a member or member organization or its affiliate to disclose in a research report if it has managed or co-managed a public offering of equity securities for a subject company in the past twelve (12) months, by deleting the word ''equity'' from the rule text. According to NYSE, the purpose of the proposed amendment is to make the Exchange's rule language consistent with the comparable NASD rule provision. As proposed, members and member organizations would be required to make such disclosures if they participated in debt offerings for a subject company as well. In amending this disclosure requirement, the Exchange recognizes that the same potential conflicts of interest exist, regardless of the type of security offering conducted by a member or member organization on behalf of a subject company.

Print Media Disclosures

As noted above, amendments currently pending with the SEC expand the definition of ''public appearance'' to include associated persons (research analysts) making a recommendation in a newspaper article or similar public medium thereby requiring such persons to make the same disclosures (*e.g.*, whether the associated person has a financial interest in and/or is an officer or director of the subject company) that are required in other public appearances (*e.g.*, TV broadcasts).

The Exchange received comments from representatives of the print media industry that extending the definition of ''public appearance'' to include print media would, in their view, infringe upon their First Amendment rights in view of the fact that the Exchange has interpreted NYSE Rule 472 to require research analysts to refrain from continued contacts with media outlets that have failed to publish or have

[25] *See* Securities Exchange Act Release No. 47384 (February 20, 2003), 68 FR 9482 (February 27, 2003).

[26] 17 CFR 242.501.

[27] 15 U.S.C. 78o–6(b)(3).

[28] NYSE Rule 472(k)(1)(iii)(b) and (d), were approved, as part of the original amendments as NYSE Rule 472(k)(1)(ii)(b) and (c). Both provisions have been renumbered as part of NYSE Amendment No. 2.

[29] NYSE Rule 472(k)(1)(iii)(a), was approved, as part of the original amendments as NYSE Rule 472(k)(1)(ii)(a). This provision has been renumbered as part of NYSE Amendment No. 2.

edited out the disclosures required by the Rule.[30]

After consideration of comments, the Exchange proposes to address this issue by providing written interpretive guidance that is hereby filed with the SEC as a proposed rule change. The proposed interpretation would require a research analyst (associated person) that recommends securities in a print media interview, newspaper article prepared under his or her name, or broadcast, to maintain a record of such interview, article, or broadcast. Such record must contain pertinent information regarding the event and the required disclosures provided to the media source. Further, such record must be made regardless of whether the media outlet publishes or broadcasts the required disclosures. In addition, records of such interviews, articles, or broadcasts and the requisite disclosures must be made in accordance with Rules 17a–3 and 17a–4 under the Exchange Act.[31]

The proposed interpretation would not require a research analyst (associated person) to refrain from further interviews, articles or broadcasts if the media source failed to publish or broadcast the required disclosures, provided the research analyst (associated person) had provided the required disclosures to the media source.

Small Firm Exemption

Currently NYSE Rules 472(b)(1), (2) and (3) (the gatekeeper provisions) prohibit ''associated persons,'' as defined in NYSE Rule 472.40, from being subject to the supervision or control of any employees of a member's or member organization's investment banking department, and further require legal or compliance personnel to intermediate certain communications between the research department and either the investment banking department or the company that is the subject of a research report by the research department. As noted above, the SEC approved exemptions from the gatekeeper provisions for small firms, on a temporary basis.[32] The Exchange is proposing that certain elements of the temporary small firm exemption to the gatekeeper provisions of NYSE Rules 472(b)(1), (2) and (3) be made permanent.[33] Those members and member organizations that meet the requirements for the small firm permanent exemption would still be required to maintain records of communications that would otherwise be subject to the gatekeeper provisions of NYSE Rules 472(b)(3)(i) and (ii). According to NYSE, proposed new NYSE Rule 472(m) would conform NYSE rules to the NASD proposal.

Implementation Schedule/Effective Dates

The Exchange is requesting the following implementation schedule for the proposed amendments being made in accordance with the SOA (all time periods commence on the date that the SEC approves the amendments) in order for members and member organizations to have adequate lead time to develop and implement procedures necessary to comply with the additional requirements of the rules.[34]

- NYSE Rules 472(k)(1)(i)(c), (k)(1)(ii), (k)(1)(iii)(c), and (k)(1)(iv) (except as it pertains to Rule 472(k)(1)(iii)(b) and (d), effective immediately upon approval))—Compensation and Client Disclosure Provisions—120 days
- NYSE Rules 472(g)(2) and 472(m)—Anti-Retaliation and Small Firm Exemption Provisions—effective immediately upon approval
- All other Rule provisions—60 days

2. NYSE's Statutory Basis

The Exchange believes that the statutory basis for the proposed rule change is section 6(b)(5) of the Exchange Act,[35] which requires, among other things, that the rules of the Exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and in general to protect investors and the public interest.

3. NASD's Purpose

In the October 2002 Filing, NASD proposed a rule change to further improve the quality and objectivity of research and provide investors with better information to make their investment decisions. Generally, the proposed rule change would effectuate the following: further separate analyst compensation from investment banking influence; prohibit analysts from issuing ''booster shot'' research reports; extend to public appearances quiet periods on research issued by underwriting managers and co-managers; prohibit analysts from issuing research where they participated in solicitation of the issuer to be an underwriter for the issuer's initial public offering; require members to publish a final research report when they terminate coverage of a subject company; change the definitions of research analyst and research report; impose registration, qualification and continuing education requirements on research analysts; and certain other changes.

According to NASD, NASD Amendment No. 2 implements provisions of the SOA regarding securities analysts. The SOA, which amends section 15 of the Exchange Act,[36] requires either the SEC or a registered securities association to enact by July 30, 2003 rules reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances. The SOA further sets forth certain specific rules that must be promulgated. According to NASD, NASD Amendment No. 2 would implement those specific rules that are not already contained in current NASD Rule 2711 or the pending rule change proposals that were published in the Original Notice.

NASD Amendment No. 2 also would create an exemption from certain provisions of NASD Rule 2711 for smaller firms that engage in limited underwriting activity. Finally, NASD Amendment No. 2 would make certain other changes to clarify language in current or proposed rules or conform language to that used in the SOA. The proposed changes are explained in more detail below.

Restrictions on Relationships With the Research Department

Section 15D(a)(1)(A)[37] of the Exchange Act restricts prepublication clearance or approval of research reports by persons not directly responsible for investment research, other than legal or compliance staff. NASD Rule 2711(b) already bans review and approval by investment banking personnel. NASD Amendment No. 2 would extend the prohibition to other non-research personnel and also require that communications about the content of a research report between all non-research

[30] *See* Letters to Jonathan G. Katz, Secretary, Commission from: Bloomberg News, dated February 19, 2003; Securities Industry Association, dated March 10, 2003; and Newspaper Association of America, dated March 10, 2003.

[31] 17 CFR 240.17a–3 and 17 CFR 240.17a–4.

[32] *See* note 13 *supra.*

[33] The Exchange is not proposing to exempt these members and member organizations from NYSE Rule 472(b)(4), which restricts communications between the research department and the subject company, because the Exchange believes that those communications do not result in the same burdens as NYSE Rules 472(b)(1), (2), and (3). NYSE Rule 472(b)(1), (2), and (3) were approved as part of the original amendments. NYSE Rule 472(b)(3) has been renumbered as part of NYSE Amendment No. 2 as NYSE 472(b)(4).

[34] *See* NYSE Amendment No. 1 for proposed implementation dates for amendments pending with the Commission.

[35] 15 U.S.C. 78f(b)(5).

[36] *See* note 8 *supra.*

[37] 15 U.S.C. 78o–6(a)(1)(A).

personnel and the research department be intermediated by legal or compliance staff.

Quiet Periods

Section 15D(a)(2)[38] of the Exchange Act requires establishment of periods during which brokers or dealers who have participated or are to participate in a public securities offering as underwriters *or dealers* may not publish or otherwise distribute research reports related to the issuer of the offering. NASD Rule 2711(f) currently imposes such quiet periods—for 40 calendar days following an initial public offering and 10 calendar days following a secondary offering—on underwriting managers and co-managers, but not on other members of the underwriting syndicate or selling group. According to NASD, to comply with the SOA, NASD Amendment No. 2 would establish a 25-day period after the ''date of the offering'' during which an underwriter or dealer other than a manager or co-manager would be prohibited from publishing or distributing research on the issuing company's securities. This 25-day prohibition effectively codifies a *de facto* quiet period that exists because of the prospectus delivery requirements under Rule 174 under the Securities Act.[39] In general, brokers or dealers refrain from issuing research on exchange-listed or National Market System securities for 25 days after a registration statement becomes effective or bona fide public trading begins to avoid the risk that such communications may be deemed prospectuses that do not meet the requirements of section 10 of the Securities Act.[40]

NASD Amendment No. 2 also would define ''date of the offering'' for all quiet period provisions to mean the later of the effective date of the registration statement or the first date on which the security was bona fide offered to public.

Prohibition of Retaliation Against Research Analysts

Section 15D(a)(1)(C)[41] of the Exchange Act prohibits a broker or dealer engaged in investment banking activities from directly or indirectly retaliating, or threatening to retaliate, against a research analyst who publishes a research report that may adversely affect a member's present or prospective investment banking relationship. NASD Amendment No. 2 creates new NASD Rule 2711(j) to implement this directive and extends the prohibition to public appearances. The proposed rule incorporates language in SOA that clarifies that the prohibition does not limit a member's authority to discipline a research analyst, in accordance with the member's policies and procedures, for any cause other than writing a research report or the making of a public appearance that is unfavorable to a current or potential investment banking relationship. NASD has further clarified in the proposal that the anti-retaliation provision would not preclude termination, in accordance with firm policies and procedures, for causes unrelated to issuing or distributing such adverse research or for making an unfavorable public appearance regarding a current or potential investment banking relationship.

Receipt of Compensation and Disclosure of Client Relationships

Section 15D(b)(2)[42] of the Exchange Act requires disclosure by a broker or dealer in research reports, and by a research analyst in public appearances, if any compensation has been received by the broker or dealer, or any affiliate thereof (including the analyst), from the issuer that is the subject of the report or public appearance. Section 15D(b)(3)[43] of the Exchange Act further requires disclosure if the subject issuer is, or has been during the previous year, a client of the broker dealer, and if so, the types of services provided to the issuer. Section 15D(b)(2)[44] of the Exchange Act is subject to exemptions as the Commission may determine appropriate and necessary to prevent disclosure of material non-public information regarding specific potential future investment banking transactions of the issuer.[45]

According to NASD, these mandates necessitate several changes to current NASD Rule 2711. First, NASD Rule 2711 currently requires disclosure only of investment banking compensation received from a subject company or its affiliates in the past 12 months. Accordingly, NASD Amendment No. 2 would expand the required disclosure to cover any compensation received by a member or its affiliates from the subject company. While the SOA does not specify a look-back period, NASD has established a 12-month retrospective period to be consistent with existing NASD Rule 2711 and section 15D(b)(3)[46] of the Exchange Act, which imposes the same timeframe for disclosure of a client relationship with the subject company.

NASD Amendment No. 2 would require separate disclosure of investment banking compensation and other, non-investment banking compensation received from the subject company or its affiliates. NASD believes this approach will result in more meaningful disclosure by separating out investment banking compensation, which NASD believes generally is the primary influence on research objectivity. Absent the separate disclosure, investors might not learn whether disclosure of compensation received by the member from the subject company came from lucrative Investment banking services or less remunerative and influential business lines. NASD specifically requests comment on whether a *de minimis* exemption would be appropriate for this provision, and if so, at what dollar level such exemption should be set.

Second, NASD Rule 2711 currently does not expressly require disclosure of compensation received by a research analyst from a subject company. To the extent that receipt of such compensation constitutes an actual, material conflict of interest, disclosure would be required under NASD Rule 2711(h)(1)(C). Nonetheless, NASD is amending NASD Rule 2711 to require disclosure of any compensation received by an analyst from the subject company in the past 12 months.

Third, NASD is amending NASD Rule 2711 to add a provision that requires a research analyst to disclose in public appearances if the member or any of its affiliates received any compensation from the subject company within the past 12 months. A research analyst must only disclose this fact if the analyst knows or has reason to know it to be the case.

Fourth, NASD is amending NASD Rule 2711 to require disclosure in research reports and public appearances if the subject company is, or has been over the preceding 12 months, a client of the member. If this disclosure is applicable, the member (in research reports) or the research analyst in public appearances (if the research analyst knows or has reason to know) must also disclose the types of client services provided to the subject company. These services may be described as falling into

[38] 15 U.S.C. 78o–6(a)(2).

[39] 17 CFR 230.174.

[40] 15 U.S.C. 77j.

[41] 15 U.S.C. 78o–6(a)(1)(C).

[42] 15 U.S.C. 78o–6(b)(2).

[43] 15 U.S.C. 78o–6(b)(3).

[44] 15 U.S.C. 78o–6(b)(2).

[45] The exemptive language of the SOA appears only in section 15D(b)(2) of the Exchange Act (15 U.S.C. 78o–6(b)(2)). However, NASD and the staff of the Exchange believe that the exemption must be interpreted to apply to certain other disclosure requirements that could tip material non-public information regarding a specific potential future investment banking transaction or else the purpose of the exemption would be frustrated.

[46] 15 U.S.C. 78o–6(b)(3).

one of the following three categories: (1) Investment banking services, (2) non-investment banking securities-related services, or (3) non-securities services.

Small Firm Exemption

NASD Amendment No. 2 also would create new NASD Rule 2711(k), an exemption from NASD Rule 2711(b) for certain firms that engage in limited underwriting activity. NASD Rule 2711(b) prohibits a research analyst from being subject to the supervision or control of any employee of a member's investment banking department and further requires legal or compliance personnel to intermediate certain communications between the research department and the investment banking department.

As the Commission noted in the May 10th Order, several commenters argued that the gatekeeper provisions of NASD Rules 2711(b) and (c) would impose significant costs, especially for smaller firms that would have to hire additional personnel. Commenters also noted that personnel often wear multiple hats in smaller firms, thereby causing a greater burden to comply with the restriction on supervision and control by investment banking personnel over research analysts. These comments raised the prospect that the rules might force some firms out of business or reduce important sources of capital and research coverage for smaller companies and companies of regional or local interest.

To temporarily address those concerns while it considered an appropriate exemption, NASD delayed effectiveness of NASD Rules 2711(b) and (c) until July 30, 2003, or until a superseding permanent exemption is approved by the SEC and becomes effective, for those members that over the previous three years, on average per year, have participated in 10 or fewer investment banking transactions or underwritings as manager or co-manager and generated $5 million or less in gross investment banking revenues from those transactions.[47] NASD Amendment No. 2 would create a permanent exemption from NASD Rule 2711(b) for those members that meet the same eligibility requirements as was required for the temporary exemption. NASD is not proposing to exempt these members from NASD Rule 2711(c), which restricts communications between the research department and the issuer, because NASD believes those communications do not result in the same burdens as NASD Rule 2711(b).

NASD Amendment No. 2 also would require members that qualify for this exemption to maintain records for three years of any communication that otherwise would be subject to the review and monitoring provisions of NASD Rule 2711(b)(3).

Other Changes

NASD Amendment No. 2 also would conform certain existing rule language with that used in the SOA. For example, the term ''publish or otherwise distribute'' has been substituted in place of references to research reports that are ''issued'' or ''published.'' The amendment also would make a few other non-substantive language changes.

Effective Dates

NASD suggests the following effective dates for the new provisions contained in SR–NASD–2002–154 and this Amendment thereto:

- NASD Rule 1050—Registration of Research Analysts: such time as announced in a *Notice to Members* after SEC approval of the rule change, but not less than 180 days from such approval
- NASD Rule 1120(a)(5) and (b)(1)—Regulatory and Firm Elements: Not less than 180 days after SEC approval of the rule change
- NASD Rule 2711(h)(2)(C)—Disclosure of Non-Investment Banking Compensation: 120 days after SEC approval of the rule change
- NASD Rule 2711(h)(2)(E)—Disclosure in Public Appearances of Compensation Received from Issuer and Affiliates: 120 days after SEC approval of the rule change
- NASD Rule 2711(h)(2)(F)—Disclosure of Client Relationship and Types of Services: 120 days after SEC approval of the rule change
- NASD Rule 2711(h)(2)(G)—Exemption from Disclosure Requirements:

—As applied to disclosures under NASD Rules 2711(h)(2)(B)(ii) and (iii): Immediate upon SEC approval of the rule change

—As applied to disclosures under NASD Rule 2711(h)(2)(F): 120 days after SEC approval of the rule change

- NASD Rule 2711(j)—Prohibition of Retaliation Against Research Analysts: Immediate upon SEC approval of the rule change
- NASD Rule 2711(k)—Small Firm Exemption: Immediate upon SEC approval of the rule change
- All other provisions: 60 days after SEC approval of the rule change

4. NASD's Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Exchange Act,[48] which requires, among other things, that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that this proposed rule change will reduce or expose conflicts of interest and thereby significantly curtail the potential for fraudulent and manipulative acts. NASD further believes that the proposed rule change will provide investors with better and more reliable information with which to make investment decisions.

B. Self-Regulatory Organizations' Statements on Burden on Competition

The NYSE and the NASD do not believe that the proposed rule changes will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, as amended.

C. Self-Regulatory Organizations' Statements on Comments on the Proposed Rule Changes Received From Members, Participants or Others

The NYSE and NASD have neither solicited nor received written comments on the proposed rule changes. Comments received by the SEC in response to the Original Notice will be addressed together with comments received after publication of NYSE Amendment No. 2 and NASD Amendment No. 2.

III. Date of Effectiveness of the Proposed Rule Changes and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Exchange consents,[49] the Commission:

[47] *See* Securities Exchange Act Release No. 47876 (May 15, 2003); *See also* Securities Exchange Act Release No. 46165 (July 3, 2002), 67 FR 46555 (July 15, 2002).

[48] 15 U.S.C. 78o–3(b)(6).

[49] *See* Letters to James Brigagliano, Assistant Director, Trading Practices, Division, Commission from: Darla Stuckey, Corporate Secretary, NYSE, consenting to an extension of the statutory time under section 19(b)(2) of the Exchange Act, until the Commission takes action on Rule filing SR–NYSE–2002–49 (December 27, 2002); and Philip Shaikun, Assistant General Counsel, NASD consenting to an extension of the statutory time under section 19(b)(2) of the Exchange Act, until the Commission takes action on Rule filing SR–NASD–2002–154 (December 27, 2003).

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning NYSE Amendment No. 2 and NASD Amendment No. 2, including whether the amendments are consistent with the Exchange Act and whether there are any differences between the NYSE and NASD proposals that present compliance or interpretive issues.

On April 28, 2003, Commission Chairman William H. Donaldson, NASD Chairman and CEO Robert Glauber, NYSE Chairman and CEO Richard Grasso, and other regulators, announced the completion of enforcement actions against a number of the nation's largest investment banking firms.[50] The enforcement actions finalized a settlement in principle reached and announced by regulators last December.[51] The settlement followed joint investigations by the regulators of allegations of undue influence of investment banking interests on securities research at brokerage firms. The Commission notes that certain elements of the settlement cover areas addressed by the SROs in the Original Notice; however, the requirements are not identical. In light of the settlement, the Commission solicits additional comment on the NYSE and NASD rule changes that were proposed in the Original Notice.

In addition, the Commission specifically solicits comment on proposed NASD 2711(k) and proposed NYSE 472(m), which address small firms. In particular, the Commission requests comment on whether the proposed thresholds for the small firm exception are appropriate (ten or fewer investment banking services transactions as manager or co-manager and $5 million or less in gross investment banking revenues from those transactions). Should the $5 million limit apply to gross revenues from all investment banking services transactions rather than only to those for which the firm acted as manager or co-manager?

The Commission notes that, in addition to proposing rules to meet the requirements of the SOA and the small firm exception, in NYSE Amendment No. 2 the Exchange also proposed an Interpretation relating to public appearances and the print media that would require members to make and keep records of information relating to public appearances. The NASD has not included a similar record-keeping requirement in NASD Amendment No. 2. The Commission requests comment on whether this record-keeping requirement is appropriate, and whether both SROs should adopt such a requirement.

Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule changes that are filed with the Commission, and all written communications relating to the proposed rule changes between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room in 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of such filing will also be available for inspection and copying at the principal offices of the SROs. All submissions should refer to File Nos. SR–NYSE–2002–49 and SR–NASD–2002–154 and should be submitted by June 19, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[52]

Margaret H. McFarland,

Deputy Secretary.

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[50] SEC Press Release No. 2003–54 (April 28, 2003).

[51] SEC Press Release No. 2002–179 (December 20, 2002).

[52] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47898; File No. SR–OCC–2002–11]

Self-Regulatory Organizations; the Options Clearing Corporation; Order Approving Proposed Rule Changes To Modify the Stock/Loan Hedge Program

May 21, 2003.

I. Introduction

On May 21, 2002, The Options Clearing Corporation (''OCC'') filed with the Securities and Exchange Commission (''Commission'') and on July 16 and September 26, 2002, amended proposed rule change SR–OCC–2002–11 pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'').[1] Notice of the proposal was published in the **Federal Register** on March 4, 2003.[2] For the reasons discussed below, the Commission is approving the proposed rule changes.

II. Description

The purpose of the proposed rule change is to modify OCC's Hedge Program, under which OCC operates a centralized facility for clearing stock loan/borrow transactions between OCC clearing members. In order to provide enhanced risk management while maintaining the flexibility of the current program, OCC proposes to establish: (i) Heightened financial requirements as a condition for clearing members to designate accounts as margin-ineligible; (ii) additional eligibility requirements for eligible securities; and (iii) limits on the notional value of the stock loan/borrow position that a clearing member may maintain in a single stock in a margin-ineligible account.

OCC's Hedge Program is intended to facilitate stock lending transactions among OCC's clearing members. Clearing members effecting stock loan/borrow transactions through the Hedge Program obtain the advantages of centralized clearing of those transactions as well as reduced credit risk through the substitution of OCC as the counterparty in all transactions. Unless a clearing member has designated an account as margin-ineligible for purposes of the Hedge Program, stock loan and borrow positions are margined by OCC's TIMS [3] margin system using the same basic risk assessment procedures that are used for positions in options or futures. For many clearing members, this results in an important advantage of the Hedge Program. By taking into consideration the reduction in risk where stock loan/borrow positions are on the opposite side of the market from option positions on the same underlying stock, the margin system will calculate a reduced margin requirement for the account containing the offsetting positions.[4]

[1] 15 U.S.C. 78s(b)(1).

[2] Securities Exchange Act Release No. 47402 (February 25, 2003), 68 FR 10291.

[3] The Theoretical Intermarket Margin System, known as TIMS, uses advanced portfolio theory to recognize economically and statistically reasonable hedges among various positions and to correctly assess the dollar risk of those positions.

[4] While similar offset may exist between positions in index options and a group of stock loan/borrow positions that are identified as baskets comprised of constituent securities in the index, the stock borrow basket/stock loan basket feature of the Hedge Program, although provided for in the OCC By-Laws and Rules, has not been placed into operation for